

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 94-304-W - ORDER NO. 97-232
MARCH 21, 1997

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IN RE: Application of Upstate Heater Utilities,) ORDER
Inc. for Approval of an Increase in its) GRANTING
Water Rates and Charges.) INCREASE IN
) RATES AND
) CHARGES

I.

INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (the Commission) on the Order of the Circuit Court remanding this Docket to the Commission for reconsideration. The Commission had previously issued Order No. 94-1279 and Order No. 95-151, which denied the request of Upstate Heater Utilities, Inc. (Heater or the Company) for an increase in its rates and charges. Pursuant to the Circuit Court's first Order remanding the matter to the Commission, the Commission re-examined the case and granted an increase in the Company's commodity charge in Order No. 95-1491. After reconsideration, Heater appealed once more to the Circuit Court, who has once again remanded the matter back to us for further consideration. This Order is therefore being issued.

II.

FINDINGS OF FACT

Based upon the Application, the testimony and exhibits

received in the evidence at the hearing, and the entire record of these proceedings, the Commission now makes the following findings of fact:

1. Upstate Heater Utilities, Inc. is a water utility providing water service in its service areas within South Carolina, and its operations in South Carolina are subject to the jurisdiction of the Commission, pursuant to S.C. Code Ann. §58-5-10, et seq. (1976, as amended).

2. The appropriate test period for the purposes of this proceeding is the twelve-month period ending March 31, 1994.

3. By its Application, the Company is seeking an increase of its rates and charges for water service of \$71,309 which Staff has calculated to be \$71,836.

4. The appropriate per book operating revenues for the Company for the test year under present rates are \$364,341.

5. The appropriate operating expenses for the Company's South Carolina operations for the test year per book under its present rates is \$308,087.

6. The Company's appropriate level of net operating income for return per books is \$56,864.

7. A year end, original cost rate base per books of \$792,313 should be adopted.

8. The Commission will use the operating margin as a guide in determining the lawfulness of the Company's proposed rates and the fixing of just and reasonable rates.

9. A fair operating margin that the Company should have the

opportunity to earn is 1.19% which is produced by the appropriate level of revenues and expenses found reasonable and approved herein.

10. The rate designs and rate schedules approved by the Commission as described herein are appropriate and should be adopted.

11. The rates and charges depicted in Appendix A, attached herein, and incorporated by reference, are approved and effective for service rendered on and after the date of this Order.

III.

EVIDENCE AND CONCLUSIONS

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 1.

The evidence supporting this finding concerning the Company's business and legal status is contained in the Company's Application and in prior Commission Orders in the Docket files of which the Commission takes notice. This finding of fact is essentially informational, procedural, and jurisdictional in nature, and the matters which it involves are essentially uncontested.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACTS NOS. 2 AND 3.

The evidence for these finding concerning the test period and the amount of the revenue increase requested by the Company is contained in the Application of the Company and the testimony and exhibits of the Company's witnesses.

The Company's filing was based on a test period consisting of the twelve months ending March 31, 1994. The Commission Staff and

the parties of record herein likewise offered their evidence generally within the context of that same test period.

A fundamental principle of the ratemaking process is the establishment of a test year period. The Commission finds the twelve months ending March 31, 1994, to be the reasonable period for which to make its ratemaking determinations herein.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 4.

The evidence for the findings concerning the level of operating revenues is found in the testimony and exhibits of Company witness Hilburn and Commission Staff witness Hulion. For purposes of this proceeding, the appropriate operating revenues for the Company for the test year under the present rates per book is \$364,341. Using the Commission's Finding of Fact No. 9 and the Evidence and Conclusions, infra., approving a 1.19% operating margin, the Company's operating revenues shall be \$358,590.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACTS NOS. 5, 6, AND 7.

Operating expenses per book for the test year were \$308,087 as reflected in the testimony of Company witness Hilburn and Staff witness Hulion. The Commission hereby approves all adjustments as agreed upon between the Company and the Staff. The adjustments on which the Company and the Staff differ are discussed as follows.

The Company proposed an adjustment of \$8,357 to operating and maintenance expense, and a (\$5,758) adjustment to general expenses to annualize salaries and wages based on current levels. Staff proposed an \$8,772 adjustment to operating and maintenance

expenses, and a (\$6,302) adjustment to general expenses for said annualization. The Commission adopts the Staff's adjustment, since its figures were updated and documented during the audit of the Company by the Staff.

The Company proposed an adjustment of \$980 to adjust the gross receipts tax to the proper level. Staff recommended an adjustment of \$1,486. The Commission adopts Staff's adjustment, since it calculated the tax using the most current gross receipts tax rate available at that time, the .975 rate of September 1994. The Company employed the old September 1993 tax rate of .83. Since Staff used the most current rate available, we adopt Staff's adjustment.

The Staff and the Company proposed to adjust miscellaneous expenses to reflect the year end level. The Company recommends an adjustment of \$44, and the Staff, an adjustment of \$37. The Commission adopts the Staff's adjustment, since Staff correctly eliminated a \$7 fee for job search, which should not be chargeable to the ratepayers.

Both Staff and Company proposed to amortize rate case expenses over three years. The Company recommends an adjustment of (\$5,380), whereas Staff recommends an adjustment of (\$8,660). The Commission adopts Staff's adjustment, since the Company used estimated expenses, and Staff used actual expenses obtained during the audit.

Both Staff and Company proposed to record the effects of annualizing depreciation expense. The Company recommends an

adjustment of \$10,429, whereas the Staff recommends an adjustment of \$9,961. After consideration of the calculations of both Staff and the Company of this expense, we conclude that Staff's calculation most correctly states the proper amount of the expense.

Staff proposes to record the effects of interest synchronization on income taxes. The Company's adjustment of zero is based on the proposed adjustment to interest expenses. The Staff recommends an adjustment of \$8,469. The Commission adopts Staff's adjustment as the more accurate, since it gives the Company tax coverage for the interest on debt associated with rate base increases. Here, Staff's adjustment is clearly advantageous to the Company.

Staff proposes to compute the effects of customer growth based on as adjusted net operating income, and recommends an adjustment of (\$308). The methodology utilized by Staff to compute customer growth for the test year is shown on page 13 of the exhibit of the Accounting Department, which is part of the record in this case. This is applied to adjusted net operating income to arrive at the recommended Staff adjustment. Since we believe that it is advantageous to the Company to apply a customer growth factor in that this attempts to account for known and measurable growth, we adopt Staff's adjustment.

The Staff and Company both propose to true-up income taxes based on as adjusted taxable income. The Company proposes an adjustment of \$14,811, Staff recommends an adjustment of \$6,342.

The Company arrived at its figure by calculating negative income taxes, whereas the Staff calculated its figure based on zero taxes, since there is an operating loss after interest expense. We see no advantage to anyone to allow the Company to include a negative income tax figure. The Commission therefore adopts the Staff's adjustment.

We therefore hold that the total operating expenses for the test year are \$322,418, and the Company's appropriate level of net operating income for return is \$28,121.

The Company's rate base is determined by the Commission to be appropriate for the purposes of this proceeding as set forth as follows:

TABLE A

ORIGINAL COST RATE BASE

MARCH 31, 1994

Gross Plant in Service	\$1,281,365
Accumulated Depreciation	(205,603)
Net Plant in Service	<u>1,075,762</u>
Meters & Supplies	9,811
Cash Working Capital	31,028
Contributions in Aid of Construction	(224,214)
Accumulated Deferred Income Taxes	<u>(29,006)</u>
TOTAL RATE BASE	<u>\$ 863,381</u>

Both Staff and Company propose to book the effect of annualizing depreciation. The Staff recommends an adjustment of (\$2,260), and the Company, an adjustment (\$2,728). The Commission adopts Staff's adjustment. (See discussion above.)

Further, both Staff and Company propose to allocate a portion of the general office and common plant to the upstate. Both Staff and Company recommends an adjustment of \$81,029 to utility plant in service, and an adjustment of (\$7,701) to accumulated depreciation for a total adjustment of \$71,068 to net plant in service. The Commission adopts these adjustments.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF
FACTS NOS. 8, 9, 10, AND 11.

Under the guidelines established in the decisions of Bluefield Water Works and Improvements Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce net revenues. As the United States Supreme Court noted in the Hope Natural Gas decision, supra, the utility "has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures." However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility and... that are adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." Bluefield, supra, at 692-693.

Neither S.C. Code Ann. §58-5-290 (1976) nor any other statute prescribes a particular method to be utilized by the Commission to

determine the lawfulness of the rates of a public utility. For ratemaking purposes, this Commission examines the relationships between expenses, revenues, and investment in an historic test period because such examination provides a constant and reliable factor upon which calculation can be made to formulate the basis for determining just and reasonable rates. This method was recognized and approved by the South Carolina Supreme Court for ratemaking purposes involving utilities in Southern Bell Telephone and Telegraph Co. v. The Public Service Commission of S.C., 270 S.C. 590, 244 S.E.2d 278 (1978).

For water utilities, the Commission may decide to use the "operating ratio" and/or "operating margin" as guides in determining just and reasonable rates, instead of examining the utility's return on its rate base. The operating ratio is the percentage obtained by dividing total operating expenses by operating revenues. The obverse side of this calculation, the operating margin, is determined by dividing net operating income for return by the total operating revenues of the utility.

The Commission finds that its use of the operating margin has resulted in fair rates to both the utility and ratepayer. In this proceeding, the Commission will use the operating margin as a guide in determining the lawfulness of the Company's proposed rates and the fixing of just and reasonable rates. This method was recognized as an acceptable guide for ratemaking purposes in Patton v. South Carolina Public Service Commission, 280 S.C. 288, 312 S.E.2d 257 (1984).

The following Table indicates the Company's gross revenues for the test year under the presently approved schedules; the Company's operating expenses for the test year; and the operating margin under the presently approved schedules for the test year.

TABLE B

Operating Revenues	\$364,341
Operating Expenses	<u>308,087</u>
Net Operating Income (Loss)	56,254
Add: Customer Growth	610
Total Income for Return (Loss)	<u>56,864</u>
Operating Martin (After Interest)	<u>1.19%</u>

The Commission is mindful of those standards delineated in the Bluefield decision, supra, and of the balance between the respective interests of the Company and of the consumer. The Commission has considered the spectrum of relevant factors in this proceeding; the revenue requirements for the Company, the proposed price for which the Company's service is rendered, the quality of that service, and the effect of the proposal upon the consumer, among others.

With regard to the Hope and Bluefield standards requiring that this Commission establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility" and "to enable it to raise money for the proper discharge of its public duties," we do not believe that much weight need be given to such standard in this case. As shown by the testimony of Company President William Grantmyre, Upstate Heater is not that

large a component of the overall Heater system, comprising, at the time of the hearing, approximately 4.5% of the overall customer base of Heater's North and South Carolina operations.

Specifically, Grantmyre testified that the strength of the Company's North Carolina earnings were the basis for a loan it obtained from the National Bank of Cooperative in any case. Tr., Vol. 2, Grantmyre at 82-83. We therefore question whether the Hope-Bluefield standards are entitled to much weight in this proceeding, since the Company has been able to obtain loans based on overall Heater earnings in any case.

Further, we believe that the proposed price of the water is too high, given the substantial questions regarding the quality of the water raised by the customers of the system at the night hearing in Anderson on November 28, 1994. See Tr., Vol. 1. We also note that the Staff's water audit revealed a higher than normal percentage of "non-account" purchased water. The Staff found such water to be 8.41%, with "normal" being considered 7.54%. See Tr., Vol. 3, Creech at 62-63. This indicates water leakage in the system.

Further, we hold that the effect on the consumer, should we grant the requested rate increase, would be problematic. In our opinion, an increase of 20.51% as proposed by the Company is excessive, and is much more than the consumers of the area should pay for the water that they are getting from the system. In light of these factors, we must then consider the criteria of a sound rate structure.

The three fundamental criteria of a sound rate structure have been characterized as follows:

...(a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost apportionment objective which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or consumer rationing under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between costs incurred and benefits received.

Bonbright, Principles of Public Utility Rates (1961), p. 292.

The Commission has considered the proposed increase presented by the Company in light of the various standards to be observed and the interests represented before the Commission, and the various factors discussed above.

Based upon the record in the instant proceeding, the Commission concludes that a fair operating margin that the Company should have an opportunity to earn is 1.19% which requires annual operating revenues of \$358,590. The following Table reflects an operating margin of 1.19%:

TABLE C

Operating Revenues	\$358,590
Operating Expenses	324,861
Net Operating Income	<u>33,729</u>
Customer Growth	366
Total Income for Return	<u>34,095</u>
Operating Margin (After Interest)	<u>1.19%</u>

The Commission finds that this operating margin provides

additional annual revenues of \$8,353 after all approved adjustments. The Commission holds that this additional revenue shall be derived by an increase in the present commodity rate from \$2.60 per 1,000 gallons to \$2.70 per 1,000 gallons. This rate structure appears in Appendix A attached hereto. The Commission finds that the rates and charges approved herein achieve a balance between the interests of the Company and those of its customers. These rates and charges result in a reasonable attainment of the Commission's ratemaking objectives in light of applicable statutory safeguards.

We also believe that a comparison of this operating margin with other company's margins is an unnecessary gesture. The Commission must fashion an operating margin specific to the circumstances of each company. Although we realize that the operating margin granted herein may be a reduction from the prior margin granted to the Company, we believe that it is appropriate, considering the various factors as described above.

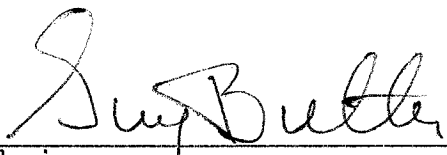
IT IS THEREFORE ORDERED THAT:

1. The originally proposed schedule of rates and charges by the Company is found to be unreasonable and is hereby denied.
2. The schedule of rates and charges attached hereto as Appendix A is hereby approved for service rendered on or after the date of this Order. The schedule is deemed to be filed with the Commission pursuant to S.C. Code Ann. §58-5-240 (1976), as amended.
3. The Company shall maintain its books and records for water operations in accordance with the NARUC Uniform System of

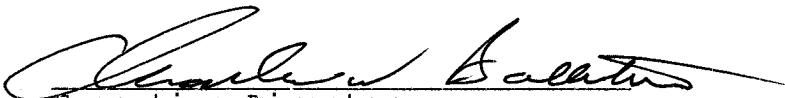
Accounts for Class B Water Utilities, as adopted by this
Commission.

4. This Order shall remain in full force and effect until
further Order of the Commission.

BY ORDER OF THE COMMISSION:


Chairman

ATTEST:


Executive Director

(SEAL)

APPENDIX A

UPSTATE HEATER UTILITIES INC.
P.O. Drawer 4889
Cary, N.C. 27519
(919) 467-7812

FILED PURSUANT TO DOCKET NO. 94-304-W - ORDER NO. 97-232
EFFECTIVE DATE: MARCH 21, 1997

THE SCHEDULE OF WATER RATES AND CHARGES ARE AS FOLLOWS:

METERED RATES (PER SINGLE FAMILY EQUIVALENT):

Basic Facility Charge (monthly)	-	\$ 8.75
Commodity Charge (per 1,000 gal.)	-	\$ 2.70
Water Reconnection Charge	—	\$ 30.00
New Customer Account Charge	—	\$ 22.00

One time fee charged to each account to
defray cost of initiating service.

* Tap fee - \$500.00

* The full gross up will be added to the tap fee.